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Nos. 233 and

In the Supreme Court of the United States

OCTOBER TERM, 1959

VANCE L. WILEY AND WIFE, LUCILLE J. WILEY, PETITIONERS,

vs.

COMMISSIONER OF INTERNAL REVENUE

FRANK D. WILEY AND WIFE, WENDLA A. WILEY, PETITIONERS,

vs.

COMMISSIONER OF INTERNAL REVENUE

PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

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RICH PRINTING COMPANY, NASHVILLE

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PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

Petitioners pray that writs of certiorari issue to review the judgment of the United States Court of Appeals for the Sixth Circuit, entered April 24, 1959, affirming a decision of the Tax Court in these cases, which were consolidated both in the Tax Court and the Court of Appeals.

OPINIONS BELOW

The memorandum opinion of the Tax Court (T. C. Memo. 1957-236, filed December 23, 1957, Appendix A hereto) is

not officially reported. The opinion of the Court of Appeals, which is in the form of an order (Appendix B hereto) is not officially reported.

JURISDICTION

The judgment of the Court of Appeals was entered on April 24, 1959. The jurisdiction of this Court is invoked under 28 U. S. C., Section 1254.

QUESTION PRESENTED

Whether an entry on the books of a finance company, crediting a trailer dealer (who employs the accrual basis of accounting) with a part of unearned interest included in a note given by the customer of the dealer for the unpaid portion of the purchase price of the trailer constitutes income to the dealer when the entry is made, even though the interest is not paid by the customer to the finance company until it becomes due under the provisions of the note, and may never be paid if the customer prepays his note or defaults in the payment thereof, and even though the dealer will never receive payment (either in cash or by way of credit on an obligation to the finance company) unless the finance company receives payment from the customer.

This question was expressly left open by the Court in *Commissioner of Internal Revenue* v. *Hansen, et al.*, and the companion cases of *Commissioner of Internal Revenue* v. *Burl P. Glover*, and *Clifton E. Baird* and *Violet L. Baird* v. *Commissioner of Internal Revenue*, decided June 22, 1959, because the respective taxpayers each failed to adduce any evidence showing that any part of the amounts credited to them on the books of the finance companies were of the character above described. The present petitioners, by special leave of the Court, filed a brief as *amici curiae* in said cases, and in their motion to file such brief asserted that "the taxpayers in the three cases now before this

Court have little or no financial incentive (and, indeed, may regard it as contrary to their financial interest) to emphasize the distinction between holdbacks and finance reserves, which the Commissioner has ignored, . . ." The decision of the Court of Appeals in the instant case was rendered while *Commissioner of Internal Revenue* v. *Hansen*, and companion cases, were awaiting argument and decision by this Court.

STATUTES INVOLVED

The statutory provisions involved are Sections 41 and 42(a), Internal Revenue Code of 1939, and are copied in Appendix C hereto.

STATEMENT

During the years 1950 and 1951, petitioners, Vance L. Wiley and Frank D. Wiley, were equal partners of Wiley Trailer Mart, the principal business of which was the purchase and sale of new and used trailers. It was customary for the customer to execute and deliver to the partnership an installment note, secured by a conditional sales contract, for that portion of the purchase price not paid in cash or by credit for a trade-in. The face amounts of these notes included insurance premiums and other charges, together with interest computed to the maturity of the notes, referred to as "finance charges." During the period involved the partnership customarily transferred the installment notes and conditional sales contracts to either Minnehoma Financial Company of Tulsa, Oklahoma, hereafter called Minnehoma, or Commerce Union Bank of Nashville, Tennessee, hereafter called Commerce Union. (Findings of Fact of Tax Court, Appendix A, *infra*, pp. 12, 13).

The following testimony of W. K. Bullock, president of Minnehoma (Record, 41a-44a) outlines the course of dealing between Wiley Trailer Mart and Minnehoma:

"Q. Mr. Bullock, when you purchased a contract covering a trailer sold by Wiley Trailer Mart, what entries were made on the books of Minnehoma?

"A. At the time we elected to purchase a contract, we purchased that contract for the 95% of the unpaid balance in accordance with an existing agreement between Wiley Trailer Mart and Minnehoma. The other five per cent was credited on our books to an account we called dealer reserve No. 608.[1] We also credited a portion of the finance charge to an account we termed dealers share of unearned discount, or account No. 610. Both of these accounts were carried in our books under those headings, identified also by the dealer, Wiley Trailer Mart, as well as by the individual purchaser.

* * * * *

"Q. Mr. Bullock, I will show you two sheets labeled, 'Wiley Trailer Mart, Dealers Reserve,' which is Exhibit 9-Q to the supplemental stipulation between the parties in this case. Is that the control account kept on the Wiley Trailer transactions?

"A. It is.

"Q. The left-hand credit column is labeled, '5%, 608.' Is that the account that you refer to as the dealers reserve account?

"A. Yes, sir.

"Q. And the right-hand credit column is labeled '1%, 610,' is that the account you refer to as the dealers share of unearned discount?

"A. Yes, sir.

---

[1] This 5% of the unpaid portion of the sales price of the vehicle is frequently referred to as a "holdback."

"Q. After December 31, 1950, I believe that account was changed to .5%?

"A. It was, right.

"Q. What was the purpose of separating the 5% or dealers reserve account from the 1% or dealers share of unearned discount account?

"A. The primary reason for separating the two was because the 1% 610, as shown on these forms, is a portion of the finance charge credited to that dealer from that individual purchaser's account. We could not refund any portion of this amount credited originally to the dealer until such time as it became earned because we did not know what portion of it would be earned by us or the dealers until the contract paid to maturity. We therefore had to separate the two for that purpose.

"Q. What would happen if the contract was paid prior to maturity?

A. We would then transfer the earned portion of the 1% 610 or dealers share of unearned discount over to the 5% 608 dealers reserve as a credit to that account to determine what amount was due that dealer in excess of 15% of his contingent liability which we refunded when the excess became 15% of the contingent liability.

* * * * *

"Q. What happened to the unearned portion?

"A. Refunded to the purchaser by reason of pay off before maturity.

"Q. Were any amounts chargeable to account 610

for any reason other than a refund to a purchaser or a transfer to account 608?

"A. No, sir.

"Q. Referring to the exhibit, could you tell us what amounts were transferred from account 610 to account 608 during 1950?

"A. During 1950, we transferred $28.27 from 610 to 608.

. . . . . .

"Q. Can you tell from the ledger sheet what the occasion for those transfers were?

"A. The contract was liquidated, the retail contract was liquidated was the reason for the transfers.

"Q. What amounts were transferred from 610 to 608 during 1951?

"A. $24.30, $48.98, $15.09, or a total of, I believe that would be $88.37.

"Q. And those transfers were also made because the contracts were liquidated?

"A. Yes, sir, because of maturity of the contracts."

The findings of fact of the Tax Court (Appendix A, *infra*, p. 16) contained a "typical transaction" between Minnehoma and the partnership. In this typical transaction the unpaid portion of the sales price of the trailer is $3,000. Insurance for one year is $90. Interest at 6% per annum for four years on $3,090 is $741.60. One-sixth of this last amount, or $123.60, was the partnership portion of the interest, or finance charges, credited by Minnehoma

to the account in the name of the partnership, which Mr. Bullock referred to as "dealer's share of unearned discount," or account No. 610.[2]

The findings of fact of the Tax Court (Appendix A, *infra*, p. 17) also contained a "typical transaction" between Commerce Union and the partnership. As explained in the findings of fact, the Commerce Union's method of determining the partnership's portion of the finance charges differed from that of Minnehoma in that, with Commerce Union, this credit was figured as a percentage of the "unpaid balance" and varied in accordance with the term of the note and type of trailer sold, rather than being figured as a percentage of the interest. Despite this different method, the credits were carved out of the "finance charges," as the evidence and findings of fact show. Another point of difference was that the Commerce Union had only one account, not two, in which both types of credits were entered, but separately.

The following quotations from the findings of fact are significant:

> "Minnehoma and Commerce Union credited the partnership accounts with a share of the finance charges as each note was purchased. If the makers of the notes satisfied their obligations prior to maturity, they were relieved from paying some of the finance charges and Minnehoma and Commerce Union would debit the partnership accounts for a portion of the relieved charges. . . .
>
> ". . . The partnership did not receive any cash payments during 1950 and 1951 for its share of the finance charges and was not entitled to any under its agree-

[2] In the "typical transaction," which was stipulated, there was indicated separately the amount of the "holdback." In *Baird*, although Minnehoma was one of the finance companies involved, the stipulations and evidence grouped the two types of credits instead of separating them. (T. C. Memo. 1957-192).

ments. It received no interest on the amounts credited by Minnehoma and Commerce Union to its account and had no dominion or control over any part of these accounts.

". . . The partnership was allowed a share of the finance charges as a bonus for inducement for doing business with Minnehoma and Commerce Union."

(Appendix A, *infra*, pp. 17, 18)

In *Commissioner of Internal Revenue* v. *Hansen*, and companion cases, the Court said that the percentages of the finance charges credited to the dealers were not "identified and separated in character and amount from the percentages of the purchase price of the installment paper that were retained by the finance companies and entered on their books as liabilities to the dealers in their respective Dealers Reserve Accounts." In the instant case they were identified and separated. As stated by the Tax Court in the first paragraph of its opinion (Appendix A, *infra*, p. 19), the petitioners had conceded the taxability of the "holdbacks" by the finance companies from the face amount of discounted paper representing the original selling price of trailers, so that there is involved in this case only the unearned interest credited to the partnership as a bonus or inducement for doing business with Minnehoma and Commerce Union. This is the issue decided both by the Tax Court and the Court of Appeals. The only other reported case dealing expressly with this precise question is *Arthur* v. *Morgan*, 29 T.C. 63.

In the *Hansen* case and its companion cases, each addition to the "reserves" would ultimately either be paid to the dealer in cash or used to satisfy his obligations to the finance company. Each addition had been fully earned by the dealer when the entry was made, so far as the evidence showed. In the instant case, (and in the *Morgan* case) additions to the "reserves" were carved out of unearned inter-

est charges which might never be paid by the customer or received by the dealer in any form. Nevertheless, the Tax Court upheld the determination of the Commissioner that the portions of the finance charges credited to the partnership's accounts were income in the year credited. The Court of Appeals reviewed the decision under the authority conferred by 26 U.S.C. Section 7482, and affirmed it.

REASON FOR GRANTING WRITS

1. The instant case squarely presents the question expressly left open in *Commissioner of Internal Revenue* v. *Hansen*, and companion cases, decided June 22, 1959, because of the failure of the taxpayers in those cases to adduce the evidence necessary to present the question properly. Not having had the benefit of the opinion of this Court, the Court of Appeals erroneously failed to recognize the distinction between the question here presented and the question presented in *Schaeffer* v. *Commissioner of Internal Revenue*, (C. A. 6, 1958) 258 F. 2d 861, where the taxpayers were held liable on facts similar to those in *Hansen*, *Glover* and *Baird*.

2. At least one Tax Court case (*Morgan, supra*) involving the identical issue is pending on appeal, and numerous other taxpayers who have the same problem are affected. It is in the public interest that the question be definitely settled by this Court, after having been left open in *Hansen*, *Glover* and *Baird* because of failure by the particular taxpayers (perhaps deliberate) to adduce the necessary evidence.

3. The decision of the Court of Appeals in the instant case is in conflict with the principles set forth by the opinion of this Court in *North American Oil Company* v. *Burnet*, 286 U. S. 417, 423 (second issue). The Court of Appeals misconstrued *Brown* v. *Helvering*, 291 U. S. 193, where the commissions were not only received but were fully earned when received, there being no evidence that

they contained any element of compensation for services to be rendered in later years.

4. The decision of the Court of Appeals for the Sixth Circuit in the instant case is in conflict with the decision of the Court of Appeals for the Second Circuit in *Bressner Radio, Inc.* v. *Commissioner*, decided May 28, 1959, reversing the Tax Court, 28 T. C. 378, and holding that payments for future services actually *received* by a taxpayer on the accrual basis should not be reported if *unearned*. In the instant case, the Court of Appeals for the Sixth Circuit has held that *unearned* potential payments (erroneously referred to by the Court as "prepaid") must be reported even though only *promised* to be paid in the future *if* earned.[3] In *Bressner Radio, Inc.*, the Court of Appeals for the Second Circuit has analyzed the opinions of this Court on the subject of accrual taxation and rendered its decision in the light of principles stated in *Automobile Club of Michigan* v. *Commissioner*, 353 U. S. 180, 189, 190, and prior decisions of this Court, including *Brown* v. *Helvering*, *supra*.

CONCLUSION

For the foregoing reasons this petition for writs of certiorari should be granted.

Respectfully submitted,

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[3] Cf. *Your Health Club, Inc.*, 4 T. C. 385 (1944), criticized in 67 Yale Law Journal 1425, notes 5 and 6, as an incorrect application of the "claim of right" doctrine, which is actually based on a "bird in hand" policy.

APPENDIX A

MEMORANDUM FINDINGS OF FACT AND OPINION

T. C. Memo. 1957-236.

TAX COURT OF THE UNITED STATES.

VANCE L. WILEY and LUCILLE J. WILEY,

Husband and Wife,
Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

FRANK D. WILEY and WENDLA ANITA WILEY,
Husband and Wife,
Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Dockets Nos. 54,454, 54,455.

Filed December 23, 1957.

William Waller, Jr., Esq., for the Petitioners.

George L. Hudspeth, Esq., for the Respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION

Opper, Judge: In these consolidated proceedings respondent determined the following income tax deficiencies and additions to tax:

Petitioner	Year	Deficiency	Additions to Tax Sec. 294 (d) (2)	Additions to Tax Sec. 294 (d) (1) (B)
Vance L. Wiley and	1950	$ 6,307.22	$ 658.76	$
Lucille J. Wiley	1951	14,395.70	1,365.76	178.28
Frank D. Wiley and	1950	6,407.24	643.76	
Wendla Anita Wiley	1951	14,477.66	1,380.94	208.63

By amended answers respondent affirmatively pleaded the following additional deficiencies and additions to tax:

Petitioner	Year	Deficiency	Addition to Tax Sec. 294 (d) (2)
Vance L. Wiley and	1950	$ 990.32	$ 59.42
Lucille J. Wiley	1951	2,662.48	159.74
Frank D. Wiley and	1950	990.34	59.42
Wendla Anita Wiley	1951	2,662.46	159.74

The main issue is whether sums credited by financial institutions to the reserve accounts of a partnership of which petitioners Vance L. Wiley and Frank D. Wiley were members, which credits represented a portion of the finance charges on installment trailer sales made by the partnership, were taxable income to petitioners in 1950 and 1951. The additions to tax imposed under section 294 (d) (2), Internal Revenue Code of 1939, are contested only insofar as they relate to the main issue. Other issues raised by amended answers and amended petitions have been conceded by either petitioners or respondent.

FINDINGS OF FACT.

The stipulated facts are hereby found.

Petitioners Vance L. Wiley and his wife, Lucille J. Wiley, and Frank D. Wiley and his wife, Wendla Anita Wiley, filed joint income tax returns for 1950 and 1951 with the collector of internal revenue for the District of Tennessee. Vance L. Wiley and Frank D. Wiley, hereafter called petitioners, were equal partners of Wiley Trailer Mart, hereafter called the partnership, which had its principal offices in Nashville, Tennessee, and branch offices in Memphis, Knoxville and Tullahoma, Tennessee, and Camp Campbell, Kentucky. In 1950 and 1951 the partnership

kept its books and records on an accrual basis and filed its income tax returns with the same collector as did petitioners.

The principal business of the partnership during 1950 and 1951 was the purchase and sale of new and used trailors. Upon the sale of a trailer it customarily received only a portion of the purchase price in cash or in credit for a used trailer. The customer would execute and deliver to the partnership an installment note, secured by a conditional sales contract, for the balance of the purchase price. The face amount of these notes included insurance premiums, interest and other charges computed to the maturity of the notes. During this period the partnership customarily transferred the installment notes and conditional sales contracts which secured them to either Minnehoma Financial Company of Tulsa, Oklahoma, hereafter called Minnehoma, or Commerce Union Bank of Nashville, Tennessee, hereafter called Commerce Union.

In 1948 the partnership entered into a contract with Minnehoma providing the terms under which Minnehoma would accept installment notes. In 1949 this contract was amended by a letter from Minnehoma to the partnership, which provided:

> we are * * * establishing a dealer reserve. * * *
>
> The finance charge rate is hereby increased to 6% per year. 1/6th of the finance charge will be credited by us upon purchase of a contract to your reserve account. In addition we will withhold 5% of the unpaid balance of each contract we purchase from you and credit that to your reserve account.
>
> In the future, you will have a reserve account against which we can charge delinquent payments and defaults instead of having to call upon you to pay or re-purchase the full amount. As your reserve account builds up we will give you reports on charges, credits and the

balance. When the account exceeds 20% of the total of the balance of the paper outstanding we have purchased from you, the excess will be paid to you.

On November 10, 1950, the partnership entered into a new contract with Minnehoma. This new contract remained in force, without change, through 1951 and provided:

4. Each contract shall require the purchaser to pay the total cash sale prices, plus the following:

* * * * *

(d) The finance * * * charge which shall be computed on the basis of 5% on new trailers and 6% on used trailers per year or such other rate as may be set by Minnehoma from time to time, of the cash selling price plus one year of the insurance premium, less the down payment made * * * in cash or by trade-in allowance, for the time elapsing between the date of the contract and the date when the final installment shall become due:

* * * * *

6. The purchase price of each contract purchased by * * * Minnehoma * * * shall be * * * 95% of the aggregate of the retail cash sale price of the trailer-coach and all extra equipment and * * * [other expenses paid by the partnership] less the amount of the down payment made by the purchaser * * *

7. An amount to be determined by Minnehoma from time to time in its absolute discretion equal to not more than 5% of the aggregate of the retail cash sale price of the trailer coach and all extra equipment and * * * [other expenses paid by the partnership] less the amount of the down payment made by the purchaser * * * will be credited by Minnehoma to a special reserve

account in the name of * * * [the partnership] which account will be referred to as the "Dealer Reserve Account." In addition, Minnehoma may credit to such Dealer Reserve Account * * *, but shall not be obligated so to do, * * * 1/10 on new trailers and * * * 1/12 on used trailers, or such other portions as Minnehoma may determine from time to time, of the finance charge paid or agreed to be paid by the purchaser in each contract. * * * Minnehoma may, at its own option, charge against the Dealer Reserve Account any sums that the * * * [partnership] may at any time owe to Minnehoma in any connection whatsoever. In the event * * * the Dealer Reserve Account shall exceed 15% of the aggregate unpaid balances of all contracts purchased by and assigned to Minnehoma * * * [by the partnership] plus all contingent liabilities which * * * it may have with respect to such contracts, Minnehoma will pay such excess to * * * [the partnership] * * * At such time as all contracts * * * purchased and assigned to Minnehoma by the * * * [partnership] shall have been paid in full * * * and in the opinion of Minnehoma there shall be no contingent liability on the part of Minnehoma with relation thereto, Minnehoma shall pay to the * * * [partnership] the balance of the credit in such Dealer Reserve Account. * * *

8. [The partnership] * * * unconditionally guarantees the payment of all sums required to be paid under each contract purchased by and assigned to Minnehoma * * *

During 1950 and 1951, Minnehoma allowed the partnership a portion of the finance charges. On its books it established accounts in the partnership's name, constituting dealer reserve accounts to which were credited the 5 per cent "holdbacks" and the partnership's share of the finance charges.

A typical transaction between Minnehoma and the partnership during the years 1950 and 1951 may be illustrated as follows:

Sales price of trailer	$4,500.00
Down payment or trade-in allowance	1,500.00
Balance due, partnership	$3,000.00
Insurance for 1 year	90.00
	$3,090.00
Interest on note for 48 months ($3,090.00 at 6% for 4 years)	741.60
	$3,831.60
Insurance for remainder of term	270.00
Total amount of note	$4,101.60
Balance due partnership	$3,000.00
Holdback credited by Minnehoma to account in name of partnership (5% of $3,000)	150.00
Cash paid to partnership by Minnehoma	$2,850.00
Partnership portion of finance charges credited by Minnehoma to account in name of partnership (1% per year for 4 years)*	$ 123.60

* On and after January 1, 1951, ½% per year for 4 years.

During the years in question Commerce Union purchased installment notes from the partnership under the terms of an oral agreement. An outline of this plan of operation was set forth in a letter from Commerce Union to the partnership, dated March 21, 1951, and was agreed to and acknowledged by petitioner Frank D. Wiley on behalf of the partnership. This letter provided:

> No. 2. If any trailer contract becomes delinquent to the extent that it is deemed advisable to repossess the property, you shall have the responsibility of the physical conveyance of the trailer back to your premises after we have effected repossession of the trailer. You shall repurchase such contracts from us for the net unpaid balance at the time of repossession. * * *
>
> No. 3. On trailer contracts where the term is longer than 36 months these transactions shall be with full recourse and you shall upon default of 3 or more

installments agree to pay our net balance and effect repossession of the trailer.

* * * * *

No. 5. On all trailer contracts with a term exceeding 36 months we will hold back 5% of the unpaid balance as a deferred payment due you. This holdback is payable to you upon payment in full of each contract.

The remainder of this letter set forth finance rates, required insurance coverage and the amount of finance charges Commerce Union would credit to the partnership's dealer reserve account upon the purchase of a note, which credit was a percentage of the "unpaid balance" and varied in accordance with the term of the note and type of trailer sold. Commerce Union was to pay the partnership everything credited to the dealer reserve account in excess of 5 per cent of the partnership's contingent liability on all notes purchased from it by the bank.

A typical transaction between Commerce Union and the partnership during the years 1950 and 1951 may be illustrated as follows:

Sales price of trailer	$4,500.00
Down payment or trade-in allowance	1,500.00
Balance due partnership	$3,000.00
Insurance for 4 years	360.00
Interest on note for 4 years (6% of $3,360 for 4 years)	806.40
Total amount of note	$4,166.40
Balance due partnership	$3,000.00
Holdback credited by Commerce Union to account in name of partnership (5% of $3,000)	150.00
Cash paid partnership by Commerce Union	$2,850.00
Partnership portion of finance charges credited by Commerce Union to partnership account (5% of $3,000)	$ 150.00

Minnehoma and Commerce Union credited the partnership accounts with a share of the finance charges as each note was purchased. If the makers of the notes satisfied their obligations prior to maturity, they were relieved from

paying some of the finance charges and Minnehoma and Commerce Union would debit the partnership accounts for a portion of the relieved charges. During 1950 and 1951 the partnership repurchased from Minnehoma and Commerce Union all defaulted notes and no losses were charged to the partnership's reserve.

Both Minnehoma and Commerce Union notified the partnership periodically of the total amount of the partnership's share of finance charges which was held in the name of the partnership. The ultimate balance of these finance charge credits, after payment of all notes by the purchasers and payment of all amounts due by the partnership to Minnehoma and Commerce Union, was to be paid to the partnership. The partnership did not receive any cash payments during 1950 and 1951 for its share of the finance charges and was not entitled to any under its agreements. It received no interest on the amounts credited by Minnehoma and Commerce Union to its account and had no dominion or control over any part of these accounts.

The partnership was not obligated to sell and Minnehoma and Commerce Union were not obligated to purchase any trailer notes taken in by the partnership. The discounting of a note was a separate and distinct transaction between the partnership and the respective firm. Neither of these firms had anything to do with negotiations for the sale of trailers by the partnership. The partnership was allowed a share of the finance charges as a bonus or inducement for doing business with Minnehoma and Commerce Union.

As of December 31, 1949, 1950 and 1951 the balances and yearly increases of the partnership share of finance charges on all trailer notes purchased from the partnership by Minnehoma and Commerce Union, which were credited by the firms to accounts in the name of the partnership, were in the following amounts:

Firm	Balances December 31, 1949	December 31, 1950	December 31, 1951	Yearly Increase — 1950	1951
Commerce Union	$5,623.55	$ 9,409.98	$38,338.56	$ 3,786.43	$28,928.58
Minnehoma		8,839.00	9,124.34	8,839.00	285.34
Total	$5,623.55	$18,248.98	$47,462.90	$12,625.43	$29,213.92

The partnership returns for 1950 and 1951 did not report any accruable income relative to the accounts maintained in its name by Minnehoma and Commerce Union for the finance charge credits. Petitioners, in their individual joint returns for 1950 and 1951, reported only their distributive share of the income reported by the partnership.

The yearly increase in credits in 1950 and 1951 to the partnership accounts by Minnehoma and Commerce Union, representing a portion of the finance charges on notes sold by the partnership, was taxable income to petitioners in 1950 and 1951, respectively.

OPINION

Petitioners contend that unlike *Blaine Johnson*, 25 T. C. 123, revd. (C. A. 4), 233 F. 2d 952, the issue here does not involve a dealer's reserve composed solely of "holdbacks" by finance companies from the face amount of discounted paper representing the original selling price of trailers. Petitioners concede that portion of the present deficiency and contend merely that amounts similarly withheld by the finance companies out of the finance charges payable by the purchaser are not income to them until they are subject to immediate collection.

While this issue may have been present in *Blaine Johnson*, supra, it was not then separately discussed. It is, however, disposed of in our view in the case on which *Blaine Johnson* relied, *Shoemaker-Nash, Inc.*, 41 B. T. A. 417. Even the Court which reversed *Blaine Johnson* would very possibly have found against petitioners in the present case. This appears from that Court's interpretation of *Shoemaker-Nash, Inc.*, supra, in referring with approval to a

quotation from *Royal Motors, Inc.*, a Memorandum Opinion of the Tax Court:

> 'We pointed out, and the Circuit Court of Appeals for the Third Circuit in Keasbey and Mattison, supra, recognized the soundness of our view, that the amounts placed in the so-called reserve were not true reserves but were nothing more than part of a plan set up by the finance company to provide for payment to the dealer of a portion of the purchase price of the notes.'

Here also the portion of the finance charge which is in excess of the price of the trailer, and which forms the source of the reserves presently in controversy, is an accrued profit which petitioners are entitled to receive as a result of the sale of the notes, they having already been paid in full for the trailer itself.

What the present procedure in effect amounts to is that petitioners disposed of their trailer paper at a profit; that the amount due them for this profit was entered as such on the books of the finance companies, but that payment was withheld pending the final outcome of the transaction. In a comparable situation in *Shoemaker-Nash, Inc.*, supra, we said (p. 423):

> From the above it is, in our opinion, apparent that the sale of notes of automobile purchasers to the finance companies was as much a part of the business carried on by the petitioner as the sale of the automobiles themselves * * * and, the petitioner being on the accrual basis, we find nothing in this case to justify the conclusion that the profit from the sale of such notes is not accruable when the notes are sold. * * * For, although the amount of the reserve credit is not immediately paid and does not become immediately payable, there is no showing that it will not be collectible when due or that its collection in the future is improbable.

If any part of the reserve fails of collection because the underlying paper proves to be uncollectible, "petitioner's compensation for that part will come by way of a specific bad debt charge-off." [1] *Blaine Johnson*, supra, at 131. If, on the other hand, petitioners fail to collect because the notes are prepaid, deduction will presumably be allowed as for a loss. *Charles G. Berwind*, 8 T. C. 1112; *Foundation Co.*, 14 T. C. 1333, 1353. That the percentage of finance charges which will ultimately fail of payment is now reasonably ascertainable is a conclusion we cannot reach on the present record.[2] A reserve to cover such contingencies even if one had been set up on petitioners' books would accordingly not be permissible. In a similar situation it was said:

> The liability * * * arising from expected future cancellations was not deductible from gross income because it was not fixed and absolute. In respect to no particular policy written within the year could it be known that it would be canceled in a future year. Nor could it be know that a definite percentage of all the policies will be canceled in the future years. Experience taught

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[1] Although the issue is not present here, the theory upon which *Blaine Johnson* was decided appears to be equally applicable. The finance companies were entitled to charge against petitioners' reserves on their books any discounted paper which becomes uncollectible. This was by reason of petitioners' agreement to repurchase or, in effect, guarantee the payment of any defaulted paper. When they made good on this agreement, whether by cash payments or through debits to their account on the finance company's books, they again became the primary obligee of the trailer purchaser, and since the debt automatically became worthless at that time, they were entitled to charge it off. *Shiman v. Commissioner* (C. A. 2), 60 F. 2d 65, reversing 21 B. T. A. 288 *Daniel v. Gimbel*, 36 B. T. A. 539. It is true that in *Johnson v. Commissioner* (C. A. 4), 233 F. 2d 952, 958, it was said to have been "conceded by the government at the hearing of this appeal that no deduction for these charges was taken by taxpayer in his income tax returns * * *." Whether or not this concession was justified, since the record and the findings in the Tax Court suggest no such evidence, is not of immediate present significance. The crucial proposition is that petitioners had the right to charge these amounts off whether or not they did so. Incidentally, in the case before us there is no evidence in this respect either way.

[2] "The experience of prepayments and losses may, of course, also change in the future, making the amount ultimately received by the dealer more or less than the amount estimated at the hearing." Pet. br. p. 15.

> that there is a strong probability that many of the policies written during the taxable year will be so canceled. * * * [*Brown* v. *Helvering*, 291 U. S. 193, 201.]

Any failure to collect the amounts which the finance companies recorded as owing to petitioners "would be the consequence of a condition subsequent." *Arthur V. Morgan*, 29 T. C. . . . (October 17, 1957). "Under these circumstances, we think the partnership's right to receive the net amount of the addition to the reserve during the taxable period became fixed, requiring its accrual by the partnership, under the principle of *Spring City Foundry Co.* v. *Commissioner*, 292 U. S. 182." *Arthur V. Morgan*, supra. See also *Albert M. Brodsky*, 27 T. C. 216. And if the reversal of *Blaine Johnson*, supra, is not distinguishable, we have in numerous instances since that time respectfully reverted to the position originally taken in the Tax Court opinion. *Arthur V. Morgan*, supra; *Albert M. Brodsky*, supra; *Texas Trailercoach, Inc.*, 27 T. C. 575; *West Pontiac, Inc.*, 27 T. C. 749; *Charles M. Kilborn*, 29 T. C. . . . (October 24, 1957).

To enable computation of conceded adjustments.

Decisions will be entered under Rule 50.

APPENDIX B

Nos. 13,737-13,738

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

No. 13,737

VANCE L. WILEY, ET AL., *Petitioners*,

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*

No. 13,738

FRANK D. WILEY, ET AL., *Petitioners*,

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*

ORDER

Filed April 24, 1959
Carl W. Reuss, Clerk

BEFORE: MARTIN, Chief Judge, MILLER, Circuit Judge, and BOYD, District Judge.

In *Schaeffer* v. *Commissioner*, 258 F(2) 861, C. A. 6th, we held that certain "hold-backs" by a finance company from the proceeds of a note executed by the purchaser of an automobile to the automobile dealer and sold by the

dealer to the finance company, which "hold-backs" were credited in a dealer's reserve account on the books of the finance company, constituted accrued income to the dealer, who made return of income on the accrual basis, at the time of the transaction. The petitions for review of decisions of the Tax Court, which are now before us, present the same basic question and are controlled by our ruling in the *Schaffer* case unless there is some material factual difference between that case and the present ones.

Petitioners urge upon us as a distinguishing feature the following fact. In the present case, the source of the dealer's reserve account set up on the books of the finance company represented an obligation on the part of the purchaser of the automobile trailer to pay what is termed finance charges, but which were actually prepaid interest to the date of maturity of the note, *in addition* to the unpaid balance of the purchase price. This additional amount was included in the note executed by the purchaser of the trailer to the automobile dealer and sold by the dealer to the finance company. If the note was paid before maturity only the portion of this amount earned at the time of payment, plus a penalty, would be actually paid and the finance company would debit the dealer's reserve account for such portion of the relieved charge. The Tax Court sustained the Commissioner's contention that this dealer's reserve account was accrued income to the dealer at the time it was entered on the books of the finance company. *Wiley* v. *Commissioner*, 26 P-H Memo. T.C., 1957-236.

Petitioners contend that this obligation of the purchaser was a contingent one; that the amount credited to the dealer's reserve account was merely a bookkeeping entry representing an unearned credit subject to a debit if the note was paid before maturity, with the result that the amount so debited was never earned and never received by the dealer, and that such bookkeeping entry could not be treated

as accrued income to the dealer at the time the entry was made.

In our opinion, the factual difference is not sufficient to distinguish this case in principle from the ruling in the *Schaeffer* case. *Brown* v. *Helvering*, 291 U.S. 193, 200-201; *Heiner* v. *Mellon*, 304 U.S. 271, 276; *Burnet* v. *Sanford & Brooks Co.*, 282 U.S. 359; and cases cited by the Tax Court in its Memorandum Opinion.

IT IS ORDERED that the decisions of the Tax Court be affirmed.

Approved for entry:
s/ SHACKELFORD MILLER, JR.
United States Circuit Judge.

APPENDIX C

STATUTES INVOLVED.

Internal Revenue Code of 1939 (26 U. S. C.):

"Sec. 41. General Rule.

"The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. If the taxpayer's annual accounting period is other than a fiscal year as defined in section 48 or if the taxpayer has no annual accounting period or does not keep books, the net income shall be computed on the basis of the calendar year."

"Sec. 42. Period in Which Items of Gross Income Included.

"(a) General Rule. The amount of all items of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under section 41, any such amounts are to be properly accounted for as of a different period. In the case of the death of a taxpayer whose net income is computed upon the basis of the accrual method of accounting, amounts (except amounts includible in computing a partner's net income under section 182) accrued only by reason of the death of the taxpayer shall not be included in computing net income for the period in which falls the date of the taxpayer's death."